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Financial Markets

Irving Trust

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Release of the first official estimates of real gross national product growth and price inflation for the first quarter of 1983 provided market participants with a good opportunity to puzzle over the ambiguous. As it turns out, the economy is growing even less vigorously than had been expected. To make matters worse, the inflation rate stood at a 5.8% annual rate. These numbers should not be taken entirely at their face value, however, although they teach some valuable lessons. First, GNP growth was weak because government spending unexpectedly dropped in the first quarter, and this won't continue. Nevertheless, it does highlight the importance of the government in the recovery. Second, the implicit price deflator was affected by some technical problems in the first quarter. If we look instead at the chain price index (which uses a fixed basket of goods), we find the inflation rate at 3.5% per year, down from 5.1% last quarter. Still, unit labor costs continue to rise at about 6% per year. Thus what the GNP price deflators tell us is that inflation is being lowered, but is not licked. What kind of policy is being pursued in these circumstances?

Unfortunately we continue along a path that has been fraught with contradiction for nearly half a year. The pace of monetary expansion is too fast; interest rates remain too high; the budget deficits are too great; and the rate of economic growth is very sluggish--all at the same time. These circumstances did not develop overnight, nor will they be alleviated that quickly. The resulting policy tension stems from the fact that the Fed runs monetary policy (and has run it quite well, even if severely), while the Administration runs fiscal policy, and each is tugging in the opposite direction with an election year on the horizon.

So far, President Reagan has tacitly agreed with monetary policy as implemented. Chairman Volcker has been less congenial; he has criticized the Administration's large budget deficits and the policy of nonintervention on the exchange markets. His tight-fisted monetary policy would probably lead him to continued vigilance even into the election year--were he to retain his position.

Realizing that there are election-year pressures around the corner, Chairman Volcker is acting pre-emptively by presiding over a monetary policy that is almost too tight to permit recovery. Recovery, however, remains the top goal, although a weak one is quite acceptable, perhaps even desirable. A slow recovery flirts less with renewed inflation and will tend to move private-sector credit demands more slowly toward their possible collision with the prospective demands of the government. To ease this tension, Mr. Volcker has tried to "jawbone" down long rates, but so far this hasn't worked. Unless the money supply suddenly begins to cooperate, it appears that the Fed will hold interest rates somewhat tighter than even it would like. Next year, election-year pressures may bring somewhat easier policies.

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Market Yields

	4/22/83 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	10.50%	10.50%	16.50%
Effective since	2/28/83		
Discount Rate at Federal Reserve Bank	8.50	8.50	12.00
Federal Funds	8.50	8.63	14.63
Repurchase Agreements	8.50	8.63	14.00
U.S. Treasury Issues			
Bills			
3 months	8.44	8.39	12.80
6 months	8.74	8.69	13.40
1 year	8.98	8.93	13.60
Coupons			
2 years	9.60	9.49	13.90
4 years	9.97	9.86	13.85
7 years	10.35	10.21	13.70
10 years	10.44	10.32	13.70
Long Bond	10.54	10.38	13.15
Negotiable Certificates of Deposit-Secondary Market			
1 month	8.50	8.55	14.20
3 months	8.55	8.55	14.20
6 months	8.75	8.70	14.15
1 year	9.15	9.10	14.20
Banker's Acceptances			
1 month	8.50	8.60	14.15
3 months	8.55	8.60	14.15
6 months	8.75	8.70	14.05
Eurodollar Deposits			
1 month	9.06	9.00	15.00
2 months	9.13	9.13	15.00
3 months	9.19	9.13	15.00
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	8.63	8.76	14.11
1 month	8.68	8.68	14.24
3 months	8.81	8.81	14.17
Bank Holding Companies			
1 month	8.30	8.68	14.10
Dealer Placed:			
3 months	8.54	8.78	14.86
New AA Corporate Utility Bond	11.65	11.65	15.80
Tax Exempt			
6 month Project Notes	5.20	4.60	7.60
1 year AAA Bond	5.25	4.75	7.50
5 year AAA Bond	6.40	6.50	9.10
20 year AAA Bond	8.60	8.25	11.60

This information represents prevailing market yields.
It should not be construed as an offering.
All yields are on the offered side of the market.

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